CC: 96-45

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
	:	[redacted]
Investigation into forward-looking	:	
economic cost studies for non-rural local	:	
exchange carriers.	:	

ORDER

DATED: May 6, 1998

TABLE OF CONTENTS

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own Motion	:	
	:	**97-0515**
Investigation into forward-looking economic cost studies for non-rural local exchange carriers.	:	

ORDER

By the Commission:

I. BACKGROUND

On October 8, 1997, the Commission initiated the instant proceeding to determine the appropriate forward-looking economic costs for purposes of determining federal support to non-rural LECs offering services in rural, high cost, and insular areas. On October 20, 1997, the Staff Report was filed in this proceeding. Several significant actions taken by both the FCC and this Commission preceded the opening of this docket.

On May 8, 1997, the FCC issued its First Report and Order In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (rel. May 8, 1997) ("First Report and Order"). As a means for determining the appropriate level of federal support for universal service to rural, insular, and high cost areas, the FCC invited state commissions to submit state-specific cost studies for the FCC's review and approval. Id., ¶206.

The FCC requires that the state studies submitted by non-rural local exchange carriers ("LECs") be based on forward-looking economic costs ("FLEC"). In a Public Notice released on November 12, 1997, the FCC clarified that a state may submit separate, company-specific cost studies for each non-rural LEC in the state. The FCC encouraged states to use the same cost methodology to the extent possible for both the federal universal service program and the state commissions' pricing of unbundled network elements ("UNEs").

On August 13, 1997, the Commission notified the FCC by letter that it elected to submit state cost studies instead of defaulting to the yet-to-be determined FCC model. At the time that the Commission notified the FCC of its intent, the Commission was in the process of reviewing Ameritech Illinois' Total Element Long Run Incremental Cost ("TELRIC") studies for purposes of determining the prices of Unbundled Network Elements ("UNEs"). Dockets 96-0486/0569 ("TELRIC Proceeding"). Initially, the FCC set the date for submission as February 6, 1998. The FCC later extended the date to April 24, 1998 and now the filing date is set for May 26, 1998.

On February 17, 1998, or eight days before the evidentiary hearing herein, the Commission issued its Second Interim Order in the TELRIC proceeding, resolving many of the outstanding cost issues before the Commission in that proceeding.

In ¶ 250 of the First Report and Order, the FCC articulated ten criteria to be applied to determine whether state-specific studies will be accepted. The FCC criteria require that state-specific studies:

(1) develop costs using forward-looking technologies for supported services, i.e., least-cost, most-efficient, and reasonable technologies for providing the supported services that are currently being deployed, based on characteristics of incumbent local exchange companies ("ILECs") wire centers such as the location of switches, line counts and actual average loop lengths;

(2) identify costs for any network function or element such as loop, switching, transport and signaling;

(3) develop costs based on long-run forward-looking economic costs and rely on the current purchase prices of plant and equipment;

(4) use the authorized federal rate of return on interstate services or the state's prescribed rate of return on intrastate services;

(5) use economic lives and future net salvage percentages to calculate depreciation expenses that are within the FCC-authorized ranges;

(6) develop costs of supported services for all business and households within a geographic region that reflect the economies of scale associated with the provisioning of these services of providing all services demanded by all customers within a geographic region;

(7) ~~make~~ assign a reasonable allocation of joint and common costs to supported services;

(8) make ~~available~~ cost studies and all underlying data, formulae, computations and software available to all interested parties for review and comment using verifiable inputs, reasonable engineering assumptions, and plausible outputs;

(9) include the capability to examine and modify critical assumptions and engineering principles such as the cost of capital, depreciation rates, fill factors, input costs, overhead adjustments, retail costs, structure sharing percentages, fiber-copper cross-over points, and terrain factors; and

(10) deaverage cost of supported services to the wire center serving area level at least, and, if feasible, to even smaller areas such as a Census Block Group, Census Block, or grid cell.

On February 27, 1998, or one day after the record was marked "Heard and Taken" herein, the

FCC issued a Public Notice, DA 98-217, which set forth, in greater detail, the information that the FCC needs to "evaluate whether a state's cost study complies with the criteria set forth in the Universal Service Order" and included a set of questions to be answered for each of the ten criteria.

At issue in this proceeding is the support calculations for non-rural carriers in Illinois - Illinois Bell Telephone Company d/b/a Ameritech Illinois and Ameritech Illinois Metro, Inc., ("Ameritech") and GTE North Incorporated and GTE South Incorporated ("GTE"). Both of these companies and Sprint Communications L.P. ("Sprint") have offered cost models and studies in this docket (although Sprint and GTE subsequently withdrew their submissions).

Petitions to Intervene were filed by the Illinois Independent Telephone Association; the City of Chicago ("Chicago"); SBMS Illinois Services, Inc.; Central Telephone Company of Illinois; AT&T Communications of Illinois, Inc. ("AT&T"); MCI Telecommunications Corporation ("MCI"); Sprint Communications Company; the Illinois Public Telecommunications Association; and the Attorney General on behalf of the People of the State of Illinois. In addition, appearances were filed on behalf of GTE North Inc., GTE South Inc. ("GTE"), and Illinois Bell Telephone Company and Ameritech Illinois Metro, Inc. (collectively or individually, "Ameritech"). All the Petitions to Intervene filed were granted by the Hearing Examiner.

Pursuant to notice as required by law and the Commission, an evidentiary hearing was held in this matter in Chicago before duly authorized Hearing Examiners on February 26, 1998. At the hearing, Ameritech presented the testimony of Milan V. Holy, Director-Economic Analysis at Ameritech Corporation. In addition, Ameritech presented the Rebuttal Testimony of John Balke, Manager of Costs Models for Ameritech's Regulatory Policy Organization. AT&T presented the testimony of James F. Henson, District Manager-State Government Affairs. MCI presented the testimony Dr. August Ankum, an Economist and Consultant. Chicago presented the Direct Testimony of Walter G. Bolter, a communications consultant. The Staff presented the testimony of Jason P. Hendricks, Economic Analyst in the Policy Section of the Telecommunications Division, and the testimony of Douglas H. Price, Section Chief-Rates in the Telecommunications Division. GTE North Incorporated and GTE South Incorporated (collectively "GTE") presented the oral rebuttal testimony of Barbara Ellis.

Initial and reply briefs were filed by Ameritech, GTE, AT&T, MCI, and Staff. Proposed Orders were filed by Ameritech, AT&T and MCI.

A Motion to Reopen the record filed by Ameritech and responded to by MCI, AT&T, and Staff, was granted pursuant to Section 200.870 of the Commission's Rules of Practice. A subsequent hearing on reopening was held on April 3, 1998, primarily for purposes of entering into the record the responses of Ameritech and GTE in the format required by the FCC's Public Notice, DA 98-217 (February 27, 1998).

On March 24, 1998 prior to the hearing on reopening, the Hearing Examiners' Proposed Order was issued and duly served on the parties. Briefs on Exceptions were filed on April 1, 1998 by Ameritech, AT&T, MCI, GTE and Staff. The sole modification proposed by Staff to clarify its position that Ameritech should use its preliminary 1997 budget data as a basis to derive shared and common costs, has been accepted and incorporated herein on page 9. The respective exceptions of the other parties are noted and addressed where appropriate in the text of this Order.

II. AMERITECH'S COST MODELS

A. Ameritech's Position

Ameritech takes the position that the Commission should submit their FLEC studies to the FCC for Universal Service cost purposes, given the substantial time and effort invested by all concerned in the TELRIC proceeding. Ameritech contends that the TELRIC proceeding laid the groundwork for virtually everything which it proposes, that the TELRIC studies in that proceeding are substantially identical to the Ameritech FLEC studies, and that only those changes necessary to meet the ten criteria and requirements of the FCC's First Report and Order were made.

Mr. Holy described the FLEC studies and the modifications made to meet the ten criteria set forth by the FCC. First, Ameritech updated the shared and common cost analysis conducted in the TELRIC proceeding. The updated study was conducted by Arthur Andersen for the purpose of analyzing the shared and common costs of the retail business units. The organizations examined for determining common costs were the same organizations examined for the common cost development in the TELRIC proceeding. Second, Ameritech modified its cost studies from the TELRIC proceeding to the extent it was necessary (as required by the FCC) to develop costs on a more granular, wire center basis. Ameritech's cost studies in the TELRIC proceedings had been developed using three geographic access areas. Third, Ameritech used the most current labor rates and loop investment costs in its FLEC studies by updating the labor rates and loop investment costs used in the TELRIC proceeding.

Mr. Holy presented Universal Service Accumulator ("USA") spreadsheets for both Ameritech Illinois and Ameritech Illinois Metro. The USA spreadsheets show the loop, port, local usage, shared and common costs as well as the total FLECs for Universal Service for each of the Ameritech wire centers. Mr. Holy described how the basic methodology used to develop these costs was the same as that used in the TELRIC proceeding, including using the same fill factors, cost of money, depreciation rates and other inputs approved by the Commission in that proceeding.

Mr. Holy also responded to other parties' testimony concerning Ameritech's shared and common cost development. With respect to Staff's concern that 1997 commitment budget data should not have been used in the shared and common cost study conducted by Arthur Andersen, Mr. Holy and Ameritech's Initial Brief point out that Ameritech used 1997 final budget data, not 1997 commitment budget data. Ameritech argues that its use of this data is consistent with the FCC's criterion concerning forward looking costs. Further, use of historical data was specifically rejected by the Commission in the TELRIC proceeding, where Staff had advocated the use of 1996 actual budget data, but the Commission approved Ameritech's use of 1997 budget data as more forward looking. (TELRIC Proceeding, Second Interim Order at 47). Accordingly, Ameritech contends that the Commission should reject Staff's recommendation.

With respect to MCI's recommendation, also endorsed by Staff, that a fixed percentage markup for shared and common costs be utilized, Ameritech points out that similar arguments by MCI and AT&T in the TELRIC docket had been rejected. In that docket, the Commission stated that, "It certainly cannot be argued that a fixed markup approach would be more accurate than using the Andersen study." (TELRIC Proceeding, Second Interim Order at 49.)

Further, Mr. Holy responded to the fact that under the MCI proposal, the fixed percentage mark up would be the same as the percentage markup used in the 1995 Wholesale proceeding in Dockets 95-0458/0531. Ameritech contends that this approach would be totally inconsistent with the TELRIC methodology for allocating shared and common costs. Ameritech further contends that the use of 1995 resale proceeding numbers would be inconsistent with the FCC's requirement of a reasonable allocation of joint and common costs. This is because pursuant to Section 252(d)(3) of the federal Telecommunications Act, the wholesale rate is based on the avoided costs of offering wholesale services in comparison to retail services. Thus, Ameritech contends that MCI's proposal would only capture the incremental difference between wholesale and retail services which in turn would substantially understate total joint and common costs related to the provision of supported retail services.

Through Mr. Holy's testimony and its brief, Ameritech also takes the position that the Commission should approve Ameritech's allocation of uncollectible expenses. Mr. Holy testified that the proposed allocation of uncollectible expenses is consistent with the methodology established in the TELRIC proceeding. Ameritech criticizes the MCI and Staff proposals that uncollectibles should be allocated based on revenues, not cost. Ameritech points out that besides being inconsistent with the TELRIC methodology, the proposal is also inconsistent with the Commission's long-standing methodology for allocating shared and common type costs, citing the Commission's Remand Order in Docket 89-0033 and the Commission's Cost of Service Rule at 83 Ill. Adm. Code 291.200 (a)(3). Ameritech argues that the Commission has required the allocation of common expenses based on underlying costs, not underlying prices or revenues, as advocated by MCI and Staff.

Mr. Holy also addressed modifications made to the Ameritech Facilities Analysis Model ("AFAM"). He testified that Ameritech used the AFAM model to develop forward-looking estimates of the investments related to feeder and distribution plant connecting central offices to end users. Ameritech modified the AFAM model to the extent necessary to develop costs on a wire center basis. (In the TELRIC proceeding, costs were developed on a more aggregate, access area level basis). He pointed out that the Commission approved the use of the AFAM model in the TELRIC proceeding.

Mr. Balke responded to criticisms of MCI concerning the AFAM model and, specifically, the placement of the Serving Area Interface ("SAI") in the AFAM model on the perimeter of the distribution/serving area closest to the central office. MCI contends that feeder facilities are cheaper than distribution facilities, thus the SAI should be moved from the perimeter of the serving area to a point closer to the center, thereby allegedly reducing costs.

Mr. Balke disagreed. He testified that a network design using the serving area concept was complex and consists of many distribution areas and feeder sections, a key point not incorporated by MCI in their oversimplified analysis. Further, he criticized Dr. Ankum's approach on behalf of MCI as being a theoretical one which totally ignored real data -- real customer locations and forward-looking engineering rules. He testified that even though placing the SAI somewhere other than the boundary may appear to be effective in an overly simplified, theoretical design used by MCI, it would not be cost effective in the developed areas where Ameritech already serves customers. Thus, routing a feeder to a SAI at a point which is closer to the center of the distribution area would require a longer feeder line and require a more complex design because the feeder would then need to be routed into and out of the distribution area and

new feeder branches would possibly be required to serve other distribution areas. All of this rerouting would result in non-standard designs that would be higher in cost than the forward-looking approach developed by Ameritech.

In its Brief, Ameritech contends that the problem with MCI's position is demonstrated by MCI's last minute, hearing data request seeking to have the AFAM model modified and rerun based on a different SAI location. (Tr. 95-105). Ameritech argues that this request demonstrates that MCI could offer nothing more than speculation on how different locations for the SAI would impact Ameritech's costs.

Mr. Balke also responded to MCI's proposal that Ameritech should deviate from the existing mixture of aerial and buried cable used under the AFAM model which Dr. Ankum stated was based on an historical mix of cable types and therefore was not forward-looking. He testified that the current mix as of today is the best predictor of forward-looking cable construction. For example, where there are poles in alleys today, they will be there in the future. Further, he contended that Dr. Ankum's approach would also be inconsistent with the AFAM methodology adopted in the TELRIC proceeding.

Mr. Holy responded to AT&T's objection to AFAM's loop investment deaveraging procedures which include the use of feeder and distribution data from other states. As explained by Mr. Holy and Ameritech's Reply Brief, while AFAM generally relies on Illinois specific data, where data is unavailable, the model collects data on plant characteristics from similar distribution and feeder routes first from other wire centers in Illinois, and if such data is unavailable, from other Ameritech states; but continues to use Illinois-specific material prices and investment information. Ameritech points out that AT&T's criticisms are inconsistent with its position that the Commission should adopt the FCC default model, which will require the use of generic, non-company specific data. Further, Ameritech argues that using data collected from other states on a carefully matched basis is far preferable to AT&T's proposal of using a Michigan bundled access line monthly cost estimate as a benchmark, where AT&T's witness conceded that his proposed cost numbers from Michigan were of limited value.

Ameritech also addressed the proposal by AT&T that would have the Commission default to the FCC's yet-to-be-determined cost model. Ameritech points out in its brief that AT&T's position in this proceeding conflicts with the position taken by its witness, Mr. Henson, in an Indiana universal service cost proceeding. In that proceeding, he endorsed the use of a state-specific approach in the development of costs for supported services. He had testified in Indiana that Indiana had unique cost characteristics; that Indiana has existing TELRIC cost information; and that Indiana had engaged in an extensive TELRIC proceeding reflecting a significant effort by the parties. He conceded that all of these factors apply to Illinois as well. Further, Ameritech contends that the reasons for changing his mind in Illinois were not persuasive. While Henson had argued that consistency required that the Commission default, he conceded during cross-examination that he had made no effort to ensure that AT&T was taking a consistent position in any other state besides those for which he was responsible. As a result, he conceded during cross examination that consistency was not a controlling basis for his recommendation. Further, while he complained about a lack of time to engage in an investigation of Ameritech's cost models, AT&T had made no effort to engage in informal or formal discovery until the last possible day when discovery was due, January 14, 1998. Moreover, AT&T had used far fewer resources here than in the Indiana universal service docket or in the Illinois TELRIC proceeding. Finally, Ameritech maintains that

AT&T's faith in the FCC cost model is unjustified because that model has not yet been determined by the FCC. Under the circumstances, it is far more reasonable to use a known cost model such as the FLEC models presented by Ameritech, which are based on the TELRIC cost studies reviewed by the Commission in the TELRIC proceeding.

Mr. Holy also responded to Staff's criticism of the fact that Ameritech had used its most current labor rates in its FLEC studies. According to Staff, Ameritech should only use labor rates (and other costs) that have previously been approved by the Commission in the TELRIC proceeding. Ameritech points out that one of the FCC's ten criteria requires the use of "long run forward-looking" economic costs. First Report and Order, ¶ 250(3)). Further, Ameritech maintains that the Commission's Cost of Service Rule requires the use of labor prices "that the carrier is actually expected to face." 83 Ill. Admin. Code, §791.60(e). Ameritech asserts that no party is questioning the accuracy of its current labor cost inputs in its FLEC studies. For all these reasons, Ameritech contends that the Commission should reject Staff's position on these inputs.

In addition, Mr. Holy addressed testimony by MCI and AT&T's witnesses questioning which vintage of switch vendor prices was used. He testified that Ameritech did not use updated switch vendor prices because they have not yet been reviewed by the Commission in the TELRIC proceeding. Instead, Ameritech used the same switch vendor prices that had been used in the TELRIC proceeding. Updating those prices will require a melding of costs which the parties will want to review in the TELRIC proceeding. Once that review takes place and the Commission approves the appropriate updated switch vendor prices, Ameritech will update its FLEC studies to include such prices. Mr. Holy testified that he could not determine, at this time, whether the use of updated switch vendor prices would increase or decrease Ameritech's costs for supported services.

Finally, with respect to AT&T's contention that common transport costs have not been included in the FLEC study (and therefore the studies are not "final"), Mr. Holy testified that the cost/price for common transport does not need to be imputed into the study of retail local usage service included in the FLEC model. Further, Ameritech contends in its Reply Brief that common transport is a combination of network elements which Ameritech is being ordered by the Commission to tariff for carriers. The costs of common transport are not the same as the costs for a retail usage service and, in fact, exclude retail type costs. Therefore, Ameritech properly did not include a cost/price for "common transport" (as defined by the Commission) in its FLEC study.

B. Staff's Position Regarding Ameritech's FLEC Models

Staff recommends that the Commission utilize Ameritech's cost models that were used for developing UNE prices for the purpose of measuring Ameritech's cost of providing universal services and submit these costs to the FCC.

Staff witness Hendricks testified that Staff was able to run Ameritech's AFAM, Switching Cost Information System ("SCIS") and Network Cost Analysis Tool ("NCAT") models and was able to replicate the results that Ameritech Illinois produced in its cost studies for all three models. In addition, Staff was able to verify that the inputs in Ameritech's models were consistent with its representations and that the

models met the FCC criteria. Staff, however, does recommend certain changes be made to Ameritech's FLEC studies. First, Staff contends that the Commission should not permit Ameritech to update the labor costs used by Ameritech in the TELRIC proceeding. The mere fact that such costs are more recent does not qualify them as long-run, forward-looking costs where they have not yet been approved by the Commission. Instead, Staff would have the Commission use the labor rates and material prices that it approved in the TELRIC proceeding because its is possible to do so and because those inputs meet the FCC's criteria. According to Staff, the FCC's third criteria provides that state commissions include only forward-looking costs and in making such determination, current costs in the market as a whole need only be considered, but not used.

Second, with respect to Ameritech's shared and common cost study conducted by Arthur Andersen, Staff contends that Ameritech had not validated the accuracy of the Arthur Andersen study. Specifically, Staff criticizes Ameritech for not providing Staff with sufficient information in a timely manner to allow Staff to fully scrutinize the study.

Further, Staff comments on Ameritech's use of 1997 final budget dollars in its Arthur Andersen study. ~~Staff acknowledges that the Commission found that the use of 1997 budget dollars was forward-looking in the TELRIC proceeding, but Staff states that it disagrees with the use of shared and common costs derived from 1997 budget dollars as being forward-looking costs. Staff disagrees with Ameritech Illinois' use of its 1997 final budget data to derive its shared and common costs. Staff notes that the Commission found Ameritech Illinois' 1997 preliminary budget data to be forward looking, and Ameritech Illinois' 1996 final budget data not to be forward looking, in the TELRIC proceeding. (TELRIC Proceeding, Second Interim Order at 48.) Thus, Staff recommends that the Commission approve the use of Ameritech Illinois' 1997 preliminary budget data as a basis to derive shared and common costs in this proceeding. (Staff Ex. 2.01 at 5; Staff Ex. 2.02 at 4; Staff Reply Brief at 16).~~ Staff asserts that as time passes and its underlying costs decrease, shared and common costs will remain a fixed amount. Further, Staff criticizes the Arthur Andersen study as spreading a fixed amount of shared and common costs to each wire center. Staff recommends that instead, such costs should be allocated to wire centers on the basis of number of lines served by each wire center. Also, Staff recommends that the Commission require Ameritech Illinois to use a fixed percentage allocator between 17.5% and 20% of its FLEC costs. Staff contends that this range of shared and common costs is consistent with the avoided retail cost percentage calculated for Ameritech by the Commission in the 1995 Wholesale proceeding.

Third, Staff took issue with Ameritech's inclusion of uncollectible expenses as part of its costs of providing universal service. Staff argued that uncollectibles are not a part of the cost of providing Universal Service because uncollectibles are not an expense. Further, Staff contends that the amount of uncollectibles assigned to wire centers should not be dependent on the cost of providing service from those wire centers. Rather, Staff takes the position that uncollectibles are a revenue component that should be accounted for as a reduction in the revenue bench-marks that the FCC determines. Accordingly, Staff contends that the Commission should not permit Ameritech to include uncollectibles as a cost of providing supportive services.

At the very outset and throughout this proceeding, Staff maintained that the only way to ensure that the universal service pool recovers costs—but does not overstate or understate costs—is to use a company-specific model and verify that the FCC standards are met. Mr. Hendricks testified that it is

important that a FLEC model not over-estimate or under-estimate a company's cost. In analyzing whether company-specific models yield more accurate FLEC estimates in a proxy model, the primary advantage to using a company-specific model is that the company has experience serving the area for which costs are being estimated. As a result, a company-specific study can better estimate the costs than a proxy model, which approximates company-specific information by using publicly available information. The yet to be determined FCC model is a proxy model.

Further, Mr. Hendricks testified that the most costly part of serving a customer in a high cost area is the outside plant. Where he compared the results of the Bench-mark Cost Proxy Model ("BCPM") with the Ameritech AFAM analysis of outside plant costs he concluded that the BCPM fails to achieve the accuracy of the AFAM model because BCPM's theoretical methodology results in an inaccurate customer location mapping which, in turn, results in inaccurate -- and generally higher -- outside plant cost estimates. He also compared Ameritech's FLEC estimates with the Hybrid Cost Proxy Model ("HCPM"), which is currently under development with the FCC's staff and concluded that the HCPM estimates are also consistently higher than Ameritech's FLEC estimates.

Staff takes issue with AT&T's proposal that the Commission default to the FCC's yet-to-be-determined proxy model. In recommending against AT&T's proposal, Staff contends that the Commission can not be assured that the FLEC's for the supported services will be accurate in an undetermined FCC model particularly where that model will use nation-wide, average cost information and inputs. Staff contends that the only way to ensure an accurate measurement of universal service costs is to use company-specific models.

Even though Staff agreed with AT&T that the Ameritech studies are not consistent with the TELRIC Order because they use labor and material prices different from those approved, Staff maintains that this should not preclude the Commission from submitting Ameritech's model to the FCC. Staff maintains that Ameritech could be ordered to utilize the approved labor rates and material prices in its model. Moreover, all of the major assumptions from the Order that can be implemented by Ameritech, i.e., cost of capital, depreciation, and fill factors, were included in the latest cost studies Ameritech provided.

Staff takes the position that Ameritech's cost studies are not final only to the extent that Ameritech should change the labor rates, material prices, and shared and common costs used in the studies. Staff argues that, contrary to AT&T's complaints, Ameritech cannot be expected to have its studies finalized until the Commission issues its Order in this docket. Indeed, the latest set of guidelines provided by the FCC will itself require certain modifications to be made, whereas, AT&T's arguments of finality would preclude such updates.

With respect to AT&T's proposed use of the interim flat-rate switching charge and common transport charge order by the Commission in its Second Interim Order, Staff agrees with Ameritech that such rates should not be used for the universal service cost studies because these are interim rates. Consistent with the FCC statement that it will reject the use of current, generally interim, unbundled elements prices for determining the cost of providing supported services, but will accept the underlying state-conducted cost studies, Staff maintains that the Commission should accept Ameritech's current studies until the final methodology for determining switching and transport rates is determined in the

continuing TELRIC proceedings.

Staff disagreed with AT&T's position that Ameritech's models do not meet the FCC's criteria. In particular, Staff rejected the contention that the wire center substitution methodology used by Ameritech fails the FCC criterion of a model based on forward-looking economic costs. According to Staff, the AFAM still produces more accurate FLECs than what could be expected from an FCC model because (1) when Ameritech substitutes wire centers from other regions it ensures that the substituted wire centers have similar size and density, and it uses the same forward-looking design rules across the region; and (2) AFAM's reliance on actual distribution areas, which were based on engineering experience in outside plant design, produces more accurate estimates than BCPM 3.1, which uses hypothetical assumptions.

Similarly, Staff disagrees with AT&T's argument that AFAM violates the FCC's ninth criterion because it cannot be easily changed to alter the location of the SAI as requested by Dr. Ankum. The FCC's ninth criterion states that the model must include the capability to examine and modify the critical assumptions and engineering principles. Staff explains that the SAI placement is an engineering assumption which underlies the model and cannot be altered by the user in the AFAM model. Similarly, however, a user cannot alter the distribution area assumptions—such as the SAI—in BCPM 3.1 and HCPM. Staff argues that it is unreasonable to expect that the user can change all algorithms and assumptions in the AFAM model for if it were otherwise, the three models being considered by the FCC, i.e., the BCPM, the HCPM, and the HAI, would all violate the FCC's criteria. Therefore, AT&T's argument has no merit.

Finally, Staff recommends that the Commission allow Ameritech to use its current SAI placement assumptions and, thus, reject MCI's proposal to have Ameritech place the SAI halfway between the median of the distribution area and the point on the perimeter of the distribution area which is closest to the central office. While MCI's recommendation might result in more cost efficient placement of the SAI in some instances, Staff claims that this is not always the result. According to Staff, Dr. Ankum recognized this fact when he recommended performing sensitivity runs to determine the optimal placement of the SAI. In addition, Staff repeats that the SAI placement is an engineering assumption which underlies the model.

C. AT&T's Position Regarding Ameritech's FLEC Models

AT&T recognizes that Ameritech submitted a FLEC model in this proceeding that was similar in nature to the TELRIC cost study submitted in the TELRIC proceeding. AT&T notes that Ameritech hoped to take advantage of the FCC suggestion which encourages the states to use TELRIC proceedings as a basis for developing costs of supported services. AT&T contends, however, that Ameritech failed to submit FLEC studies that comply with the First Report and Order. At the outset, AT&T contends through the testimony of Mr. Henson, that Ameritech has never really filed a final or complete study in this docket. AT&T argues that the February 18, 1998 USA spreadsheet filed by Ameritech (after the issuance of the Second Interim Order in the TELRIC proceeding) did not incorporate all of the Commission's findings in the TELRIC proceeding. AT&T cites to the testimony of Mr. Holy that certain areas of the Second Interim Order of the TELRIC proceeding would require additional review by the Commission before Ameritech could update its FLEC studies to incorporate findings from that Order. More specifically, AT&T faults Ameritech for the way it calculated its switching costs, and contends that Ameritech erroneously failed to

include the costs for common transport in its study of local usage in the FLEC study.

Further, Mr. Henson criticized Ameritech's FLEC model as inconsistent with the FCC's criteria because it does not rely upon Illinois-specific forward-looking economic costs. Specifically, he took issue with Ameritech's AFAM model and the use of information from wire centers outside of Illinois in instances where sufficient information was not available within Illinois. He contended that without a detailed audit and analysis, the Commission cannot be assured that the Ameritech AFAM study properly reflects forward-looking economic costs and, in particular, Illinois forward-looking costs.

In addition, AT&T agrees with MCI's criticism of the AFAM model with respect to the placement of the SAI in relationship to the boundary of the distribution area and contends that Mr. Balke's response to those criticisms was too simplistic. Further, AT&T argues that because Ameritech resisted responding to a hearing data request, demanding a rerunning of the AFAM model using an SAI placement different than that employed by Ameritech, this meant that the AFAM model did not include the ability to examine and modify the critical assumptions reflected in the model. AT&T argues that showed an inconsistency with the ninth criterion found in the FCC's First Report and Order which states that "the cost study or model must include the capability to examine and modify the critical assumption and engineering principles". AT&T also expressed concern that Ameritech's study overstates central office switching costs and that the Arthur Andersen study has never been closely examined.

For all these reasons, AT&T recommends that the Commission utilize the cost model that is ultimately adopted by the FCC. AT&T suggests that this should not be viewed as a "simple default", but rather as an "affirmative choice" which will ensure methodological consistency across companies and across states. In support of this position, AT&T argues that most of the FCC's ten criteria identified in its First Report and Order require an exercise of judgment. Moreover, if the model eventually selected by the FCC is used and properly implemented, all ten criteria will automatically be met. Even if the Commission were to adopt the Ameritech model, there is no guarantee that the FCC would agree that this model has satisfied the ten criteria. Further, AT&T argues that if the study submitted by Ameritech were corrected or enhanced in some way, the Commission would have a difficult choice regarding how updates should be done or whether the study should be frozen.

D. MCI's Position Regarding Ameritech's FLEC Models

MCI takes the position through its witness, Dr. Ankum, that the Commission should base its findings concerning the cost of supported services on the TELRIC studies and inputs that were approved by the Commission in the TELRIC proceeding. MCI, however, proposed a number of changes to Ameritech's FLEC studies because it contended that the TELRIC study, as modified by the Commission's findings in the Second Interim Order in the TELRIC proceeding, will not in and of itself provide results that are consistent with the FCC's requirements for a FLEC study.

First, Dr. Ankum contended that Ameritech's AFAM model should be modified to assume that the SAI will be placed at a point within the distribution area toward the center, instead of placing the SAI on the perimeter of the distribution area, as the AFAM model currently does. According to MCI, this modification would reflect a more efficient, forward-looking and least cost loop FLEC. MCI faulted

Ameritech for not conducting any AFAM runs that utilize the assumption for SAI placement within the distribution area as MCI recommended. MCI argues that the Commission should recognize the distribution facilities can be ten times as expensive as feeder facilities and moving the SAI toward the center of the distribution area will substitute inexpensive feeder facilities for expert distribution facility. Accordingly, MCI makes the recommendation that the Commission submit Ameritech's AFAM model to the FCC on the condition that AFAM be modified so that the SAI is placed within the distribution area half way between the center of the distribution area and the point on the perimeter of the distribution area which is closest to the serving central office.

Second, MCI takes issue with AFAM's assumption concerning the use of aerial cable versus buried cable. Dr. Ankum testified that AFAM's use of aerial cable technology in its cost calculations is not forward-looking. He contended that given the higher costs of aerial versus buried cable, the AFAM aerial cost calculations serve to increase the FLEC costs of the distribution facilities. Accordingly, MCI recommends that the Commission require Ameritech to eliminate from the AFAM decision tables any information that relies on the vintage of the living units and historic engineering designs that result in the inappropriate use of relatively expensive aerial cables instead of less expensive buried cables. MCI contends that AFAM must be modified to reflect only the most current aerial/buried cable technology mix found at p. 2 of MCI Cross Exhibit 5-P.

Third, in taking issue with Ameritech's calculation of shared and common costs. MCI complains that the Arthur Andersen study was highly complex and was not received until January 29, 1998. Dr. Ankum, therefore, objected to the use of the Arthur Andersen study because the numbers contained therein could not be verified. For this reason, he recommended that a fixed percentage mark-up equal to Ameritech's avoidable retail costs, i.e. the wholesale discount determined in Docket 95-0458/0531, be utilized.

Fourth, MCI took issue with Ameritech's allocation of uncollectibles costs. MCI criticized Ameritech's proposed method of allocating uncollectibles based on underlying costs. Dr. Ankum testified that such an allocation is inappropriate because higher cost loops would, therefore, be disproportionately burdened with costs related to uncollectibles. MCI would have Ameritech's cost model allocate uncollectibles to high cost lines based on 3.943% (as calculated in Ameritech's universal service aggregator) times the benchmark revenues determined by the FCC for residential and small business lines of $31 and $51, respectively.

Finally, MCI criticizes the switching costs incorporated by Ameritech in its FLEC studies as inconsistent with the method approved in the TELRIC Order and not based on the prices and discounts set out in its current vendor contracts. MCI, however, states that because Ameritech Illinois will not make its TELRIC Order compliance filing until April 3, 1998, the Commission should submit Ameritech's FLEC models to the FCC with the proviso that the switching costs as identified by Ameritech must be modified to reflect vendor costs and discounts consistent with the Commission's Second Interim Order in the TELRIC proceeding.

E. Chicago's Position Regarding Ameritech's FLEC Models

Chicago presented the direct testimony of Walter G. Bolter, a communications consultant. He complained that Ameritech did not provide satisfactory answers to Chicago's data requests. Accordingly, he stated that he could not render an opinion with respect to the merits of Ameritech's company-specific cost study.

F. Commission Findings and Conclusions Regarding Ameritech

The Commission will adopt Ameritech's FLEC studies, as hereinafter modified, as the studies to be submitted to the FCC for the purpose of determining the appropriate level of federal support for universal service in rural, insular, and high cost areas served by these two carriers.

The Commission finds that Ameritech's FLEC studies are consistent with the FCC's Public Notice released November 12, 1997, which encourages the use of the same cost methodology to the extent possible for both universal service and UNE purposes. Ameritech Metro has achieved this objective by adopting the methodology used for Ameritech Illinois' TELRIC studies in the TELRIC proceeding, as modified to conform with the Commission's Second Interim Order and as further modified to conform with the FCC's ten criteria set forth in the First Report and Order In The Matter of Federal-State Joint Board on Universal Service, C.C. Docket No. 96-45 (rel. May 8, 1997).

AT&T has presented no sound reason why the Commission should deviate from its original conclusion (reflected in its August 13, 1997 notice to the FCC) concerning the submission of state-specific cost studies. Given the fact that Ameritech has substantially adhered to the TELRIC methodology as reflected in the Second Interim Order in the TELRIC proceeding, the Commission sees no merit in defaulting to an as yet-to-be-determined FCC model. The Commission agrees with the reasoning of Ameritech and Staff witnesses that company-specific models will yield more accurate FLEC estimates than any proxy model adopted by the FCC because company-specific models rely upon a company's knowledge of customer locations and the costs and material inputs. In contrast, proxy models approximate company-specific information such as customer locations by using publicly available data. Further, proxy models may very well use nation-wide average cost information. Since whatever model the FCC adopts will not use company-specific information, it will likely result in either an over- or under-estimation of costs. This is not an acceptable result in a state, like Illinois, where the Commission and the parties have devoted substantial time and resources to the review of TELRIC studies presented by Ameritech Illinois in the TELRIC proceeding. For these reasons, the Commission is not persuaded by AT&T's default proposal.

The Commission now turns to the specific criticisms of the Ameritech's FLEC model. First, the Commission notes the many criticisms regarding the late submission and the voluminous nature of Ameritech's study of its shared and common costs as prepared by Arthur Andersen. Although the Commission approved an Arthur Andersen study in the TELRIC proceeding, Ameritech had Arthur Andersen extend that previous study regarding joint and common costs to incorporate the retail operating business units. While both Staff and MCI complain that they were not provided this study until 10 days before the direct testimony was due, there is no showing that any party was precluded from addressing any aspects of the study during later stages of testimony or at the hearing. Moreover, we would note that the parties had considerable time to examine much of Ameritech's methodology in the TELRIC proceeding.

In any event, Staff refers us to the Commission's observations in the TELRIC proceeding that shared and common cost studies are more accurate than fixed percentage markups. Given our interest in maintaining accuracy, we are not persuaded by MCI's and Staff's alternative proposal to use a proxy, namely, the percentage of shared and common costs from the resale proceedings, as a measure of the shared and common costs. MCI excepts to the adoption of the Arthur Andersen study for purposes of determining joint and common costs and again recommends that the Commission adopt as a percentage markup for joint and common costs the resale discounts obtained for Ameritech residential and business local service in the resale proceedings. See Resale Order Dockets 96-0458 (June 5, 1996) & 96-0531. The basis for MCI's argument that the Arthur Andersen study will most certainly inflate the costs of providing universal service in Illinois, is grounded in speculation. MCI attacks the instant study only by referencing challenges posited to the UNE study. We are not persuaded by such argument.

Staff recommends that if the Arthur Andersen study is accepted, the Commission reexamine the methodology used to spread the costs to each wire center to ensure that costs are properly applied and that small wire centers with high loop and part costs are assigned shared and common costs in relation to the number of lines in the wire center rather than on the cost of providing service. Essentially, Staff suggests that more shared and common costs should be assigned to wire centers with 10,000 lines than to wire centers with only 500 lines. We further note that on March 20, 1998, the Hearing Examiners directed Ameritech to address whether the Arthur Andersen study submitted by Ameritech excludes uncollectibles in the shared and common costs as required by the FCC's eighth criteria.

Ameritech takes exception to the requirement that shared and common costs be assigned to wire centers based on the number of access lines in the wire centers, arguing that the HEPO's conclusion on this point stands in opposition to the Commission's TELRIC Order. Ameritech further excepts to the requirement that the Arthur Andersen study use 1997 preliminary budget data as inputs, rather than 1997 final budget data. Ameritech claims that using the preliminary budget data instead of final data would likely produce higher retail shared and common costs.

We agree with Ameritech on each of these points. The record shows that Ameritech allocated shared and common costs consistent with the methodology we approved in the TELRIC proceeding. Since the FCC does not require a change to that methodology, Staff's recommendation proposing such a change will not be accepted. We are attempting to maintain consistency with the TELRIC whenever it is both reasonable and possible to do so. The Commission also finds that the use of 1997 final budget data estimates is forward looking and consistent with the methodology of the TELRIC Order. The Commission is consistent with TELRIC because here, as in that earlier proceeding, we are permitting use of the most recent and forward looking data.

With respect to uncollectible expenses, we reject Ameritech's inclusion of uncollectibles as a cost of providing universal service. It is not appropriate to include uncollectibles as Ameritech's shared and common costs because they are revenue offsets and are treated as such under State and Federal rules. See 47 CFR 32.4999, 32.50002 and 83 Ill. Adm. Code §710.1. As Staff argues, if the Commission were to treat uncollectibles as part of Ameritech's shared and common costs, then the amount of uncollectibles assigned to wire centers would be dependent on the cost of providing services to those wire centers. In other words, the amount of uncollectibles assigned to wire centers would be greater in higher cost wire

centers, and universal service would support too large a percentage of uncollectibles. We further agree with MCI that Ameritech's cost model should allocate uncollectibles to high cost lines based on 3.943% (as calculated in Ameritech's universal service aggregator) times the benchmark revenues determined by the FCC for residential and small business lines of $31 and $51, respectively. Ameritech will work together with Staff in stating this concept in an appropriate form for submission to the FCC.

The Commission agrees with Ameritech that the AFAM model properly allocates forward-looking feeder and distribution costs. MCI's proposal to move the serving area interface to a more central point in the distribution area as a means of reducing forward-looking costs was not supported by any evidence in the record, as perhaps best demonstrated by MCI's last minute data request attempting to obtain evidence with respect to the effect moving the serving area interface. Staff also explained that the SAI placement is an engineering assumption that cannot be altered by the user in the AFAM model because it is an assumption that underlies the model.

MCI excepts to the conclusion that Ameritech's AFAM model properly allocates forward-looking feeder and distribution costs and urges the Commission to require Ameritech to file cost model runs, after modifying AFAM, to the extent that the SAI is placed within the distribution area halfway between the median of the distribution area and the point on the perimeter of the distribution area which is closest to the serving central office. MCI's proposal may have validity, but it comes far too late in this proceeding. If Ameritech were ordered to make such runs, testimony to explain the process and interpret the results would be needed with hearings to follow. This would involve many additional months of discovery, litigation and briefing that our schedule in this proceeding simply does not permit.

Similarly, we are also not persuaded by MCI arguments that the AFAM model uses an improper mix of aerial and buried cable. We credit Mr. Balke's testimony that the existing mix of aerial and buried cable is reflective of the forward-looking least cost mix of such cable. Thus, when carriers serve an aerial area, they generally introduce more aerial cable into the area. Similarly, when a carrier serves a buried cable area, additional cable added to that area is generally buried. Accordingly, the pre-existing mix of buried and aerial cable is an excellent indicator of the forward-looking mix of such cable in a given area. Moreover, there is consistency with the TELRIC by use of this data.

Also taking exception to Ameritech's AFAM, AT&T argues that the model's critical assumptions and engineering principles must be capable of modification in order to satisfy the FCC's ninth criterion. AT&T contends that the testimony of Mr. Balke showed that a change in the location of the SAI was not something that could be varied. On the basis of other arguments presented, particularly those articulated by Staff, we are not convinced of AT&T's correctness in interpreting the FCC's ninth criterion. Staff explained that if it were expected for a user to be able to change all algorithms and assumptions in the AFAM then, by this standard, each of the models being considered by the FCC would themselves be deficient.

Overall, AT&T remains steadfast in its position that the Commission should allow the model eventually adopted by the FCC to be used to calculate on an interstate basis the costs for Illinois non-rural LEC's provision of universal service.

With respect to AT&T's criticism of Ameritech's use of feeder and distribution data from other states, we find that the record supports the fact that Ameritech reasonably relied on data from similar distribution and feeder areas from other wire centers in Illinois, and if such data was unavailable, from other states, while continuing to use Illinois-specific investment information. Moreover, AT&T's criticisms are inconsistent with its position that the Commission should adopt the FCC default model which will surely require the use of generic, non-company specific data. While we would prefer the use of entirely Illinois-specific data, Ameritech's approach will lead to accurate estimates of Illinois costs. We note that AT&T's alternative proposal, to use a Michigan network access line cost number as a "bench-mark" for Illinois costs, seems far less calculated to provide accurate Illinois cost estimates. Moreover, AT&T presented no evidence as to whether average cost characteristics of serving customers in Michigan are at all similar to the average cost characteristics of serving customers in Illinois.

As to AT&T's concern that the cost for common transport should have been included in the study of local usage, AT&T has not clarified how the prices for the components of what the Commission has characterized as common transport in the Second Interim Order would be helpful in determining what the incremental costs of retail local usage are. Common transport is offered only to other carriers, not to retail end users. The Commission further notes that AT&T's contention was not made until the filing of its initial brief in this proceeding. Therefore, the Commission rejects it as not supported by the evidentiary record. While AT&T raises this same point in its Brief on Exceptions, we remain unpersuaded by these arguments.

With respect to the use of updated labor rates by Ameritech in its FLEC studies, we find that Ameritech appropriately updated the labor costs used in the TELRIC proceeding. Both the Commission's Cost of Service Rule and the FCC's First Report and Order require the use of the most up-to-date labor cost information. We know that Staff has taken the position that the Commission must first review and approve updated information before it can be used in a FLEC study. While this is an appropriate approach where the numbers are contested or controversial, we note that in the case of labor costs, no parties contests the accuracy of Ameritech's updates. Therefore, we find no reason why Ameritech cannot update its FLEC studies to reflect the most up-to-date labor cost information except for Staff's equally valid interest in maintaining consistency with TELRIC whenever possible. In our review of the FCC criteria on this point, however, we interpret the third criterion to favor Ameritech's view.

With respect to switch vendor prices, the parties do not appear to oppose Ameritech's proposal that updated switch vendor cost inputs will require a melding of costs which should first be reviewed by the Commission in the TELRIC proceeding. Once that review is completed, we direct Ameritech to update its FLEC studies and submit the updated information to the Commission so that the Commission can forward it at the appropriate time to the FCC.

Finally, we note that AT&T has expressed a concern on how updates will be accomplished to FLEC studies, and how that information will properly be communicated to the FCC. The Commission is confident that the FCC will establish procedures for receiving updated information. The Commission observes that the FCC, like the Commission, has never treated costs as static and immutable, and the Commission therefore intends to apprise the FCC of significant updates to the FLEC studies after they are reviewed and approved by the Commission.

III. GTE'S COST MODELS

A. Positions of the Parties With Respect to GTE

GTE contends that there is only one model that will meet the ultimate goal of providing a cost model that most accurately reflects its actual costs of providing universal service in Illinois. GTE contends that its Integrated Cost Model ("ICM") is the best model to establish both federal and state universal service support levels. GTE notes that that ICM was filed with the Commission in Docket 96-0503, which was opened to determine its LRSIC for UNEs. GTE maintains that the ICM will not be ready for calculating the cost of providing universal service in Illinois until June 1998, which is after the April 24, 1998 FCC deadline.

On an interim basis, GTE proposes that no cost model be submitted to the FCC and, instead, allow the FCC to utilize its default proxy model for purposes of calculating the federal portion of the universal service support available in its Illinois service territories.

Staff does not agree with GTE's default proposal. Staff contends that the FCC 's HCBPM may not be the final model chosen by the FCC and as a proxy model it cannot model GTE's service area as accurately as a company-specific model. Staff notes that the HCBPM will use nationwide average cost information and inputs and because these inputs would not be company-specific, the results would either overestimate or underestimate a company's actual costs. Therefore, Staff proposes that the Commission should submit GTE's COSTMOD model until it has a model approved for UNEs.

Both GTE and AT&T take exception to Staff's proposal. Both contend that COSTMOD is not in the record. GTE, in particular, contends that COSTMOD cannot be modified as proposed by Staff witness Hendricks (Staff Ex. 1.02 at 8). GTE point to its witness, Ms. Ellis, who explained that COSTMOD was not originally designed to calculate universal service costs, particularly for Illinois where GTE has over 400 wire centers. She testified that the model would have to be run hundreds of times to desegregate costs at the wire center level to comply with paragraph 250 of the FCC's Universal Service Order. GTE also points to Staff's agreement that by submitting COSTMOD to the FCC, the Commission may be required to use COSTMOD for intrastate universal service purposes. Thus, GTE contends that neither it nor Staff recommend using COSTMOD to determine intrastate universal service support levels and so the Commission should focus on and submit the ICM to the FCC.

In addition, AT&T contends that COSTMOD may not comply with the FCC's criteria because it does not deaverage the costs associated with providing universal service to the wire center level. AT&T also contends that the COSTMOD outputs do not include common costs as required by the FCC's criteria.

In response to GTE and AT&T, Staff notes that COSTMOD was run for the purposes of measuring GTE's cost of providing Residence One Party Flat Rate Service and such service includes the cost of the loop, the port and local usage. (Staff Ex. 1.01 at 6, fn. 3, and Attachment 2, fn. 1). Staff contends that these components are fully consistent with the FCC's definition of the services that will be supported by the federal high cost USF. Staff also contends COSTMOD provides estimates of the forward-looking economic cost of providing service for GTE that are superior in accuracy to those produced by proxy

models. (Staff Ex. 1.02 at 8). Staff points out that COSTMOD can meet all of the FCC's criteria because it can be deaveraged at the wire center level. (Tr. 19-21). While Staff agrees with AT&T that COSTMOD outputs do not include common costs, Staff opines that this can be remedied by adopting MCI's proposal that the fixed percentage markup be based on the best available information, which MCI surmises is Ameritech's retail costs of providing services supported by the universal service program.

B. Commission Analysis and Conclusions

We are unable to agree with the arguments advanced by GTE and AT&T that we should default to the FCC's proxy model. We have reviewed the COSTMOD run and results on several occasions and determined that this model provides accurate estimates of the forward-looking cost of providing service by GTE. Through Staff Ex. 1.02, Attachment 3 to Mr. Hendrick's testimony, the relevant inputs and results of GTE's COSTMOD are in the record. In order to supplement COSTMOD, we would require GTE to include in this record answereds to the FCC's Public Notice with respect to its COSTMOD with the realization that costs have not yet been broken down to the wire center level.

There are ways for GTE to make its COSTMOD provide costs at the wire center level. We would direct GTE to propose the most expeditious and accurate way for it to provide such costs. We direct it to run its COSTMOD using wire center specific inputs. With respect to joint and common costs, we adopt MCIGTE's proposal that a fixed percentage mark-up of between 16% to 20%, utilizing the avoidable cost methodology approved by us for Ameritech.

AT&T took exception to modifying GTE's COSTMOD model for submission to the FCC arguing that no evidence showed that the model would comply with the FCC's criteria. While also excepting to the use of COSTMOD, GTE admitted that this model could be operated in a manner that is consistent with the FCC's criteria although it might be a time consuming task. GTE, however, also filed a written response to the taking of Administrative Notice of Dockets 93-0301/94-0041 (as requested by Staff and included in the Hearing Examiners ruling on March 20, 1998). In that document it was stated that if the Commission were to recommend COSTMOD for present purposes, GTE would propose that the desegregation of the total service area cost to the wire center level could be accomplished by using the Benchmark Cost Proxy Model ("BCPM) 3.1 to develop a ratio of wire center cost to total service area cost for GTE's Illinois service territories. With this modification, the COSTMOD would satisfy the FCC's requirement that models desegregate costs to the wire center and the effort would only take two to four weeks to execute.

Staff proposed that GTE use the BCPM inputs on an interim basis, but, further recommended that GTE be required to complete the COSTMOD estimates for each wire center using "wire center specific inputs." Since it will take only 6 months to complete this task, Staff argued that the Commission can recommend replacing GTE's instant filing with the actual completed COSTMOD estimates for each wire center, to the FCC, in sufficient time before GTE is migrated to a FLEC based support mechanism in January, 1999.

In its brief on exceptions, GTE further took issue with the HEPO's finding on joint and common costs as unsupported by the record. Instead, GTE recommended that the Commission use the 43% - 45%

range introduced in GTE's arbitration case with AT&T (ICC Docket No. 96 AB-005).

We recognize that GTE has itself proposed a reasonable and effective way to have its COSTMOD meet the FCC's requirements and we accept this effort. Further, the Commission directs GTE to run COSTMOD for each wire center using inputs specific to each of the wire centers and file the results of this study within six (6) months of this order. Upon receipt and review and review of this filing, the Commission will submit GTE's filing to the FCC and recommend that the FCC substitute this latter study in place of GTE submission on May, 1998. But, we must reject GTE's proposed mark-up on joint and common costs because the HEPO's recommendation appears more reasonable.

IV. THE FCC - FORMATTED EXHIBITS OF AMERITECH AND GTE

At the April 3, 1998 hearing, Ameritech entered into the record Ameritech Illinois Exhibit 7.0 as a late filed proprietary exhibit together with three diskettes marked as Ameritech proprietary Ex. 7.1, 7.2 and 7.3. According to Mr. Holy's testimony, this exhibit followed FCC format requirements meaning that some additional descriptions of Ameritech's inputs had to be provided. All of the numbers, however, were exactly the same as those identified in the earlier proceedings' testimony and exhibits. Ameritech agreed that it would modify either the text and/or the model inputs in order to conform with the Commission's final order.

Interested parties were permitted to file comments on Ameritech's Exhibit 7.0 by Wednesday April 8, 1998 with responses from Ameritech due on April 13, 1998. AT&T questioned Mr. Holy at the April 3, 1998 hearing, but filed no comments. MCI merely cautioned that in its present form, the responses contained in Ex. 7.0 are, simply a preliminary draft or a template of the document to be submitted to the FCC. Given that the responses ultimately must come from the Commission, and not Ameritech, MCI maintained that the final submission must reflect the Commissions own words based on the findings entered in the final order. We agree that Ameritech and Staff need to work together to fashion an appropriately styled document reflecting any changes made in our final order.

GTE was given leave to file its FCC formatted Exhibit (in response to Hearing Examiners ruling) on April 13, 1998 with the ruling that this exhibit would be entered into the record upon receipt. At the April 3, 1998 hearing, AT&T objected to the Hearing Examiners granting leave to GTE to file its Exhibit 1.0 and renewed its objections in comments filed on April 15, 1998. In those comments AT&T claimed that there was no record support for the information contained in GTE Exhibit 1.0 including the use of BCPM inputs in the manner described.

Staff took issue with any and all arguments directed to the appropriateness of the Commission recommending GTE's COSTMOD to the FCC given that parties had already addressed the matter in their Exceptions to the Proposed Order. For its part, Staff commented on the areas in which GTE Exhibit 1.0 was considered to be incomplete and gave GTE clear instructions of the information needed. Further, Staff provided specific recommendations for modifying GTE Exhibit 1.0 and reflected these modifications in a legislative style format which it attached and labeled as Staff late filed Exhibit 1.0.

MCI's comments explained that GTE Exhibit 1.00 ignores the reasonable directives of the HEPO to apply a final percentage mark-up of between 16% to 20% for joint and common costs utilizing the avoidable cost methodology approved by the Commission for Ameritech. Instead, GTE used an unsupported 43.9% mark-up. MCI

recommends that the Commission recalculate the costs per wire center based on the mark-up for shared & common costs as identified in the Hearing Examiners Proposed Order.

Having reviewed all of the parties comments, the Commission directs GTE to provide the additional information and/or explanation as indicated in Part II of Staff's comments. We further accept the modifications as set out in Part III of Staff's comments and as are contained in Staff Late Filed Exhibit 1.00. GTE has not responded to MCI's comments on the inconsistency between the mark-up on joint and common costs as adopted by the Hearing Examiners Proposed Order (10% to 20%) and as applied by GTE (43.9%). In any event, we agree that the Hearing Examiners directive to GTE as to the mark-up on joint and common costs was reasonable and will be followed.

IV. COMMISSION FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record and being fully advised in the premises hereof, is of the opinion and finds that:

Illinois Bell Telephone Company d/b/a Ameritech Illinois, Ameritech Illinois Metro, Inc., (Ameritech) and GTE North Incorporated and GTE South Incorporated (GTE) are corporations engaged in the business of providing telecommunications services to the public in the State of Illinois and, as such, are telecommunications carriers within the meaning of Section 13-202 of the Illinois Public Utilities Act;

the Commission has jurisdiction over the parties and the subject matter herein;

the recital of facts and conclusions set forth in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact and conclusions of law;

on August 13, 1997 the Commission notified the FCC of the Commission's intent to submit state-specific cost studies, and in a Public Notice released November 12, 1997 the FCC made clear that state commissions may submit separate, company-specific cost models;

Ameritech Illinois and Ameritech Illinois Metro ("Ameritech") have submitted state-specific FLEC cost studies that satisfy the ten criteria set forth by the FCC in its First Report and Order In The Matter of Federal-State Joint Board on Universal Service, C.C. Docket No. 96-45, ¶250 (rel. May 8, 1997);

on or before May 26, 1998, the Commission will submit the FLEC studies submitted by Ameritech Illinois and Ameritech Illinois Metro, with modifications as directed above, as the studies to be used by the FCC to determine the appropriate level of federal support for universal services for any rural, insular, and high cost area served by these carriers;

on or before May 26, 1998, the Commission will submit the COSTMOD study of GTE North and GTE South with specific wire center cost inputs and a fixed percentage mark-up for joint

and common costs as outlined above, as the studies used by the FCC to determine the appropriate level of federal support for universal services for any rural, insular and high cost area served by these carriers;

in addition, the Commission will submit the additional information supplied by Ameritech Illinois and Ameritech Illinois Metro in Exhibit 7.0, 7.1, 7.2 and 7.3, as well as GTE North and GTE South Exhibit 1.00 as modified, ~~as late-filed exhibits~~ because such information further details how the FLEC studies comply with the ten criteria articulated by the FCC in response to the FCC's February 23, 1998 Public Notice DA 98-217;

GTE is directed to run COSTMOD for each wire center using inputs specific to each of the wire centers and is required to file the results of this study within six (6) months of the date of this order. The Commission will review the filing and recommend that the FCC substitute this latter study in place of GTE's earlier FLEC study;

the Chief Clerk of the Commission is directed to maintain all information identified as proprietary in this proceeding in a manner which will not permit disclosure, dissemination, revelation or reproduction thereof without further order of the Commission;

any objections, petitions and motions made in this proceeding which remain undisposed of should be disposed of consistent with the ultimate conclusions herein contained.

IT IS THEREFORE ORDERED that the Commission will submit the FLEC studies provided by Ameritech Illinois, Ameritech Illinois Metro, GTE North and GTE South to the FCC on or before May 26, 1998, together with Ameritech Illinois' and GTE's late-filed ~~FCC~~ formatted exhibits answering the questions contained in the FCC's Public Notice issued on February 23, 1998.

IT IS FURTHER ORDERED that Ameritech Illinois, Ameritech Illinois Metro, GTE North and GTE South are directed to update their FLEC studies as a result of any changes to the TELRIC inputs or methodology adopted by the Commission in the next phase of the TELRIC proceeding in Docket No. 96-0486/0569.

IT IS FURTHER ORDERED that the Chief Clerk of the Commission should be directed to maintain all information identified as proprietary in this proceeding in a manner which will not permit disclosure, dissemination, revelation or reproduction thereof without further order of the Commission.

IT IS FURTHER ORDERED that any petitions, objections and motions made in this proceeding which remain undisposed of shall be disposed of consistent with the ultimate conclusions contained herein.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 6th day of May, 1998.

Chairman